Portfolio Management and the Presidency

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As sure as the sun sets each day, every four years, people obsess over what will happen if Candidate X wins the presidency.

Normally, the dialogue asserts, "If Candidate X wins, the stock market is going to crash." This is further enhanced by a recurring conspiracy theory that one political party is superior for the financial markets.

Although this cottage industry was engaging forty years ago, today it is a full-on contact sport with social media and the 24/7 news cycle. Unfortunately, the bombardment of non-stop opinions does not improve the correlation between the performance of the financial markets relative to the presidency.

As such, before making portfolio management decisions based upon the outcome of the election, consider a few things.

First, write your decisions and predictions down and post them where you can see them. For our firm, depending upon the accuracy, this is either our Wall of Fame or Shame. If you don't write it down, your market calls don't exist and revisionist history will take place adding to delusional beliefs.

Entrepreneurship and business management is incredibly difficult, even under the best circumstances. I have never seen an entrepreneur with a good business say, "If Candidate X wins the presidency, I'm no longer going to try to run my business in the most efficient manner possible." That would be irrational.

Regardless of the president, every business owner and manager will show up and work their tails off. And despite questionable decisions made by our elected leaders, capitalism will prevail and deliver respectable long-term returns.

Consider the number of bad things that have happened politically over the last fifty years. There have been impeachments, resignations, assassination attempts, acts of terrorism, financial scandals, wars, tax hikes, recessions, etc. And yet, the markets continued to make progress and society has benefitted.

However, our minds like simple stories and single themed narratives to derive conclusions. As such, many convince themselves that if Candidate X wins, the financial markets will implode—even though there is zero historical precedent for this.

The reality is that stock market returns are influenced by numerous factors such as profit margins, global trade, tax rates, interest rates, business models, the business cycle, employment, etc. Additionally, we must assess exogenous events such as a world-wide pandemic or 9/11 attacks.

Regardless of what we think the president is capable of controlling, they do not control these factors.

If you are still convinced one political party is better for the presidency, then delve deeper into the data.

According to Natixis Investments, since 1976 the financial markets have delivered more than 14% per year under a Democratic president versus a bit more than 10% under a Republican president.

Case closed, right? Wrong.

Much of the strong performance was due to the Clinton years. However, George W. Bush immediately inherited a faltering economy, technology implosion and 9/11. Between November of 2000 and October of 2008 the stock market cumulatively fell 22%. This unwound the mathematical outperformance of the Clinton years and made the performance of the presidency between the two parties more equal.

However, this should reinforce that there is a lag, a cyclicality and randomness between the policies and performance of one presidency and subsequent ones. This makes comparisons very murky and inconclusive.

There is also the matter of Congress as they must work with the president.

According to BTN Research, since 1970 the total return of the S&P 500 has been up 17.5% per year with a Democratic president and a Republican-led Congress. However, returns have only been 5.4% annually with a Republican president and a Democrat-led Congress. If the presidency and Congress are controlled by the same party returns averaged 12.3% per year. Adding further confusion to the matter, if control of Congress is split, regardless of who is in the White House, the financial markets produced returns of 10.8% per year.

Astute observers will realize that due to the power and resilience of the economy all averages resulted in positive outcomes. However, the political conclusions depend upon a variety of complicated and intertwined factors.

If investors are concerned the Democrats will sweep the presidency and Congress, consider research from Sam Stovall with CFRA Research.

The Democrats controlled the presidency and Congress in 1948, 1960, 1976, 1992 and 2008.

The S&P 500 fell an average of 2.4% in November after a Democratic sweep. However, by December of those years, the S&P 500 delivered positive performance each time with an average gain of 3.1%. More importantly, the market jumped an average of 10.4% in the subsequent calendar year.

The markets did not crash and instead rewarded long-term, patient investors.

In considering this data, we have two points to conclude with.

Regardless of who controls the presidency or Congress, assets still need to be managed in a logical manner. As such, you need a rational foundation by which decisions are made so as to not be led astray by emotion or irrational leanings. Attempting to time the market based upon concepts that are not supported with data is a fool’s errand.

Lastly, a different presidential-market observation is worth having. Instead of assessing the presidency’s influence on the stock market, the better question is, “What impact does the stock market have upon the outcome of the presidency?”

When the S&P 500 has increased in the three months prior to an election, the incumbent party usually wins the White House. When the market drops, the incumbent party usually loses. Since 1928, this trend has only been broken three times for an 87% success rate. It hasn’t missed in the last forty years.